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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 633

GENERAL GAS CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 42–45) is reported at 33 T.C. 303. The opinion of the Court of Appeals (Pet. 33–45) is reported at 293 F. 2d 35.

JURISDICTION

The judgment of the Court of Appeals was entered August 11, 1961. (Pet. 45.) A timely petition for rehearing was denied on October 2, 1961. (Pet. 46.) The petition for a writ of certiorari was filed on December 26, 1961. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

The taxpayer corporation sold its customers' obligations without recourse to financial institutions, re-

ceiving in exchange the face amount of the obligations, part in the form of cash payments and part in the form of amounts credited to a reserve account in its name on the books of the financial institution. The question is whether the entire amounts credited on the books of the financial institution, including payments for the right to receive finance charges, were taxable income to the accrual basis taxpayer in the year in which the sales and credits were made.

STATUTE AND REGULATIONS INVOLVED

The relevant portions of Sections 41 and 42(a) of the Internal Revenue Code of 1939 and Section 39.41–1 of Treasury Regulations 118, are set forth in the Appendix, *infra*, pp. 9–10.

STATEMENT

During the taxable year 1952, the taxpayer corporation was engaged in selling liquified petroleum gas, tanks and other equipment required for the storage and use of the gas, gas systems, and gas-operated and electric household appliances. It kept its books and records and prepared its tax returns on the accrual basis. (R. 53–54.) A substantial portion of the taxpayer's sales were made on an installment time-payment plan. A customer purchasing an appliance on credit would make a partial cash payment or trade-in, and would execute a promissory note for the balance due, secured by a chattel mortgage, conditional sales agreement, or other instrument of security. The notes were in face amounts which included finance charges

and were payable in installments over a period of time, usually from 12 to 36 months. (R. 54.)

Early in 1952 the taxpayer entered into contracts with three financing agencies providing for the sale to them of all acceptable customer notes, to be endorsed without recourse. These agencies were the First Bancredit Corporation of St. Paul, Minnesota, hereinafter referred to as "Bancredit"; Guaranty Bank & Trust Company of Lafayette, Louisiana, hereinafter referred to as "Guaranty"; and Refrigeration Discount Corporation of Detroit, Michigan, hereinafter referred to as "ReDisCo." The identical contracts with Bancredit and with Guaranty provided that the notes were to be endorsed to the finance agencies in exchange for payment to the taxpayer of the "net cash selling price" of the appliance less 10 per cent. The "net cash selling price" was defined in the contracts to be the "cash selling price of the merchandise financed without the addition of any finance charge, less any trade-in allowance or discount for cash, and less any down payment", or the unpaid portion of the sales price of the item purchased, not including finance charges. The agreements also provided that the aggregate amount of the 10 per cent discount and the finance charge was to be set up as a reserve account in the taxpayer's name on the books of the finance agencies. Customer payments were to be made direct to the taxpayer for immediate daily transmission to the finance agencies. The reserve account was subject to specified charges against it arising under the agreements. Payments by the finance agencies to the taxpayer from the re-

serve accounts were to be made only when the reserve exceeded 30 per cent of the balance of all outstanding notes, with the entire balance to be remitted on termination of the arrangement. While the agreement was in effect, the reserve account was not to be reduced below $10,000. The finance agencies were to receive 7 per cent interest on the balance of their investment in the notes.

The contract with ReDisCo related only to appliances sold by the taxpayer which had been manufactured by an affiliate of ReDisCo. This contract was identical to those with Baneredit and Guaranty except that there was to be no deduction of a 10 per cent discount. On the transfer of the notes, ReDisCo was to pay the taxpayer the entire "net cash selling price" of the notes without discount. The balance due from the finance company, representing the purchase price of the right to receive the finance charges, was credited to the reserve account. (R. 20–40, 57–59.)

The stipulated facts show the total amount of customers' credit-purchase notes financed in 1952, the total amount of the finance charges, and the amount in the reserve accounts of the three finance agencies at December 31, 1952. The taxpayer recorded monthly on its books the amounts in the reserve accounts which were paid or became payable to it, as a credit to income, and it reported these amounts as income on its returns. No addition to the reserve accounts was reported by the finance companies as taxable income in 1952. (R. 65–68.)

The Tax Court held that the balances in the dealer reserve accounts carried in the taxpayer's name were subject to its control and were includible in the taxpayer's taxable income for 1952. (R. 11; 14, 42–45.) The Court of Appeals affirmed. (Pet. 33–45.)

ARGUMENT

1. The decision below is correct. There is no conflict in decisions or other reason warranting further review. This case involves essentially the same basic question that was decided by this Court in *Commissioner* v. *Hansen*, 360 U.S. 446. See also *United States* v. *Hine Pontiac*, 360 U.S. 715; *United States* v. *Colonial Chevrolet Corp.*, 360 U.S. 716; *Shapiro* v. *Commissioner*, 295 F. 2d 306 (C.A. 9th), petition for certiorari pending, No. 652 this Term; *Morgan* v. *Commissioner*, 277 F. 2d 152 (C.A. 9th); and *Wiley* v. *Commissioner*, 266 F. 2d 48 (C.A. 6th), certiorari denied, 361 U.S. 831.

To support its petition for certiorari the taxpayer alleges (Pet. 15) a conflict between the decision below and this Court's decision in *Hansen*, *supra*. However, the decision below correctly applies the controlling principles of the *Hansen* case to a factual variation that this Court expressly declined to pass upon in *Hansen*. In effect, the taxpayer is contending here (as the taxpayers contended in part in *Hansen*) that amounts of credits in the dealers reserve accounts reflecting finance charges included in the face amounts of the customers' notes should not be regarded as accrued income when credited. In *Hansen*, p. 469, this

Court declined to pass upon the treatment of a reserve representing finance charges. It held only that the taxpayers had "wholly failed to sustain the burden of showing that any part of the amounts credited on the books of the finance companies to the respective Dealers Reserve Accounts was entitled to special treatment."

The courts of the Sixth and Ninth Circuits in *Shapiro, Morgan,* and *Wiley, supra,* have correctly followed the principles announced by this Court in *Hansen* by holding that the entire amount of reserves, including the portion attributable to finance charges, should be accrued. As the court below carefully established (Pet. 42), there is no basis for a distinction between that portion of a dealer's reserve representing payments for the right to receive finance charges from the retail customer and that portion representing payments for the right to receive the cash sale price. Time of accrual is determined by the nature of the obligation the dealer receives from the finance company and not by the nature of the obligation that the dealer sells to the finance company. In effect petitioner is here arguing that since the right to receive finance charges which was sold to the finance company [1] represents in part an interest element which would have been earned and accrued over a period of time if it had been retained by the dealer, the obligation of the finance company which was received in exchange for the dealer's right to receive finance charges must be accorded the

[1] There is no basis for the contention (Pet. 19) that the arrangements with the finance companies were merely pledges and not sales. The stipulation indicates that the taxpayer sold the

same treatment. But after sale of the right to receive finance charges, the petitioner-dealer no longer had a right to receive anything in the nature of interest for the use of its money over a period of time. Whether or not the finance company received interest payments from the retail purchasers, the petitioner-dealer, which had lent nothing to the finance company, did not receive interest payments from that company. It received an immediately accruable obligation of the finance company to pay the purchase price of various contracts and notes transferred by petitioner.

2. The decision below correctly held (Pet. 38–39) that no significant distinction exists between this case and *Hansen* on the ground that here the notes were transferred without recourse. Although the taxpayer admits (Pet. 8) that there is no basis for certiorari on this issue, which was urged below, it desires this Court to pass on it if certiorari is granted (Pet 8–9). This Court in *Hansen* reversed *Glover* v. *Commissioner*, 253 F. 2d 735 (C.A. 8th), which involved certain notes financed on a non-recourse basis, and treated dealer reserves resulting from such transfers in the same manner as other dealer reserves. See also *United States* v. *Hinc Pontiac, supra; Morgan* v. *Commissioner, supra;* and *Evans Motor Co.* v. *Commissioner*, 29 T.C. 555. Moreover, as the court below pointed out (Pet. 38–39), the record shows that in reality the taxpayer here undertook an obligation

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notes and that they were purchased by the finance companies (Stip. pars. 21, 26, 32, 33, 36, R. 56–60), and an examination of the contracts (R. 20–40) does not reveal that the true nature of the transactions was other than purchase and sale.

equivalent to endorsement and guaranty of the transferred notes. Consequently, it must be recognized that for tax purposes no special significance can be given to the transactions here because the notes were stated to be without recourse. There is no reason why this Court should consider this issue further.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1962.

APPENDIX

Internal Revenue Code of 1939:

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * * *

(26 U.S.C. 1952 ed., Sec. 42.)

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

SEC. 39.41–1 *Computation of net income.* Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 39.42–1 to 39.42–3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

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